

Trust to satisfy hospital's malpractice claims. A trust created by an exempt hospital for the sole purpose of accumulating and holding funds to be used to satisfy malpractice claims against the hospital, and from which the hospital directs the bank-trustee to make payments to claimants, is operated exclusively for charitable purposes and is exempt from tax under section 501(c)(3) of the Code.

Advice has been requested whether the nonprofit organization described below, which otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, is operated exclusively for charitable purposes.

The organization is a trust created by a hospital that is exempt from Federal income tax under section 501(c)(3) of the Code. The sole purpose of the trust is to accumulate and hold funds for use in satisfying malpractice claims against the hospital. The trustee of the trust is a banking institution. The terms of the trust specify that the hospital deposits 10x dollars per month in the trust fund, and continues to do so until the fund balance reaches 500x dollars. If malpractice payouts reduce the balance to below 500x dollars, the hospital will, under the terms of the trust, again resume payments at the rate of 10x dollars per month until the fund balance is again up to 500x dollars. The hospital is required by the state hospital licensing authority to carry 500x dollars of malpractice insurance, or to set aside in some manner 500x dollars for this purpose.

The hospital has also entered into a concurrent agreement with the trustee bank for a self-reducing line of credit that makes up the difference between the required reserve, and the balance actually in the fund at any given time. Malpractice claimants are paid directly by the trustee upon the order of the hospital. The hospital makes all decisions on which claims to pay, and the trustee merely acts as its agent in disbursing funds. The trust instrument specifies that the funds may be invested only in Federal or state bonds, or in interest-bearing deposits in any bank or trust company having at least a certain minimum net worth. Within these limitations, the hospital may advise the trustee as to the investment of the fund.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable purposes.

Rev. Rul. 75-282, 1975-2 C.b. 201, holds that an organization formed and controlled by an exempt conference of churches that makes mortgage loans to affiliated churches to finance the construction of church buildings is carrying out an integral part of the activities of the parent church organization, and qualifies for exemption under section 501(c)(3) of the Code.

By serving as a repository for funds paid in by the hospital, and by making payments at the direction of the hospital to persons with malpractice claims against the hospital, the trust is operating as an integral part of the hospital. Of equal importance is the fact that the trust is performing a function that the hospital could do directly.

Accordingly, the organization is operated exclusively for charitable purposes and, thus, is exempt from Federal income tax under section 501(c)(3) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the key District indicated in the instructions to Form 1023. See sections 1.501(a)-1 and 1.508-1(a) of the regulations.